

Chapter 4

DEFICITS: MANAGEMENT OF FISCAL IMBALANCES

4.1 The annual budget indicates three types of deficits, *viz.* revenue, fiscal, and primary. This chapter discusses the nature and magnitude of these deficits, their trend over time and the manner of financing these deficits. Deficits arise because of imbalances in revenue and expenditure. These imbalances could be transient or structural. In the Indian context, fiscal imbalances have both been large and persistent. Besides the size and regularity, its composition, in particular that of the revenue deficit that finances current consumption has also been a cause of concern. Formulation of fiscal rules in the context of macroeconomic activity essentially involves setting of rules regarding the size of deficit that could be incurred to finance expenditure.

4.2 Revenue deficit is the excess of revenue expenditure of the Government over its revenue receipts. It represents net dis-saving of the Government and its shift to present consumption. The revenue deficit leads to increase in borrowings without corresponding capital/asset formation. Borrowings resorted to meet revenue deficit, therefore, do not have any assets back up and create an asset liability mismatch. Because of these properties, the revenue deficit is considered generally less desirable. Section 4(1) of Fiscal Reforms and Budget Management (FRBM) Act 2003, accordingly provides that the Union Government shall take appropriate measures to reduce fiscal deficit and revenue deficit so as to eliminate revenue deficit by 31 March 2009.

4.3 Trends in revenue deficit and some of its key parameters are indicated in table 4.1 below.

Table 4.1: Revenue Deficit and its parameters

(Rupees in crore)

Period	Revenue Receipt	Revenue Expenditure	Revenue Deficit	Revenue Deficit as per cent of		
				GDP	Revenue Receipt	Revenue Expenditure
1985-2004	152850	195669	42819	3.53	28.01	21.88
VIII Plan (1992-1997)	131601	160541	28941	2.80	21.99	18.03
IX Plan (1997-2002)	237397	313109	75711	3.95	31.89	24.18
2002-03	299826	409591	109765	4.44	36.61	26.80
2003-04	339100	440086	100986	3.64	29.78	22.95
Average Annual Rate of Growth (Per Cent)						
1985-2004	13.14	14.12	18.22	3.58	4.49	3.60
VIII Plan (1992-1997)	15.61	14.64	10.88	Average Annual Rate of Shift in Relative Share		
IX Plan (1997-2002)	8.12	10.40	17.29			
2002-03	13.02	9.06	-0.49			
2003-04	13.10	7.45	-8.00			

4.4 Overall revenue deficit of the Union Government increased from an average of Rs. 28941 crore during the VIII Plan (1992-1997) to Rs. 100986 crore in 2003-04. The average annual rate of growth of revenue deficit was 18.22 *per cent*. A negative spread between the trend growth of revenue receipts and revenue expenditure contributed to the surge in revenue deficit. In relation to GDP, revenue deficit increased from an average of 2.8 *per cent* of GDP during the VIII Plan (1992-1997) to 3.64 *per cent* in 2003-04. The average annual rate of shift in the share of revenue deficit to GDP was 3.58 *per cent*. As a proportion of revenue receipt, revenue deficit increased from an average of around 22 *per cent* during the VIII Plan to 29.8 *per cent* in 2003-04. During 1985-2004, on an average, revenue receipts fell short of revenue expenditure by around 28 *per cent*. The shortfall increased to 41.6 *per cent* in 2001-02. As proportion to revenue expenditure, revenue deficit averaged 21.88 *per cent* during 1985-2004, indicating the proportion of revenue expenditure that was debt financed.

4.5 In the last two years, however, there was a decline in revenue deficit. In the year 2003-04, decline was of the order of eight *per cent*. The ratio of revenue deficit to GDP, revenue receipt and revenue expenditure also got moderated because of this decline. These two years witnessed a positive spread of over four *per cent* between revenue receipt and revenue expenditure. A relatively buoyant revenue receipt and moderately growing revenue expenditure facilitated the decline in revenue deficit and decline in its ratio relative to the major fiscal aggregates. The rate of decline of revenue deficit needs to be accelerated for the Government to be able to meet the objective of zero revenue deficits by March 2009 as set out in the FRBM Act.

Fiscal Deficit

4.6 The fiscal deficit is the excess of total expenditure of the Government over its non-debt receipts (revenue receipts, miscellaneous capital receipts and recovery of loans and advances). Fiscal deficit normally represents the net incremental liabilities of the Government or its additional borrowings. The shortfall could be met either by additional public debt (internal or external) or by the use of surplus from public account. Fiscal deficit trends along with the trends of the deficit relative to key fiscal parameters are indicated in table 4.2.

4.7 Notwithstanding a decline in the fiscal deficit in 2002-03 and 2003-04, the overall fiscal deficit increased from an average of Rs. 62565 crore during the VIII Plan (1992-97) to Rs. 80937 crore in 2003-04. The trend rate of growth of fiscal deficit was 10.25 *per cent* during 1985-2004. A moderate positive spread between the rate of growth of non-debt receipts and total expenditure lead to relatively lower increase in fiscal deficit, compared to these fiscal aggregates. The rate of growth of fiscal deficit was also lower than the rate of growth of GDP. The ratio of fiscal deficit to GDP, therefore,

declined from an average of 6.04 *per cent* during the VIII Plan (1992-97) to 2.92 *per cent* in 2003-04. The average annual rate of shift in its share was (-) 3.4 *per cent*. The average annual rate of shift in the proportion of fiscal deficit to non-debt receipts and total expenditure was also negative. A sharp decline in the fiscal deficit and in its ratios to the three fiscal parameters in 2002-03 and 2003-04 was due to a surge in non-debt capital receipts. Miscellaneous capital receipts particularly from the disinvestment of PSUs and recovery of loans and advances were buoyant during these two years. The debt swap scheme which facilitated pre payment of part of the Union Government loans, which attracted a rate of interest of 13 *per cent* or more, by the States contributed mainly to higher recovery. Further, since the required financial accommodation was provided through market loans, fresh disbursements of loans fell short of the recoveries.

Table 4.2: Fiscal Deficit and its Parameters

(Rupees in crore)

Period	Non-Debt Receipts	Total Expenditure	Fiscal Deficit	Fiscal Deficit as per cent to		
				GDP	NDR	Total Exp.
1985-2004	168807	240451	71644	5.90	42.44	29.80
VIII Plan (1992-1997)	140973	203539	62565	6.04	44.38	30.74
IX Plan (1997-2002)	254827	374502	119675	6.25	46.96	31.96
2002-03	341722	476310	134588	5.45	39.39	28.26
2003-04	425880	506817	80937	2.92	19.00	15.97
Average Annual Rate of Growth						
1985-2004	13.33	12.47	10.25	-3.40	-2.72	-1.97
VIII Plan (1992-1997)	14.51	11.87	6.42	Average Annual Rate of Shift in Proportions		
IX Plan (1997-2002)	8.74	8.86	9.00			
2002-03	17.97	6.92	-13.63			
2003-04	24.63	6.40	-39.86			

4.8 It is not uncommon for the governments to run fiscal deficit and borrow funds for capital/assets formation or for creation of economic and social infrastructure. These assets created through such borrowings could pay for themselves by generating an income stream. The capital formation may also increase the overall income generating capacity of the economy, directly or indirectly, and may enlarge the tax base. Further, in a situation where infrastructure becomes a binding constraint for growth, such capital formation by the government could make acceleration of growth more feasible. It may, therefore, be necessary to analyse various components of the fiscal deficit. If bulk of fiscal deficit is for sustaining capital expenditure or for providing financial accommodation to entities for capital formation, such deficits may be considered desirable upto a point. Table 4.3 below provides the movement of components of fiscal over plan periods and the most recent two years.

Table 4.3 Components of Fiscal Deficit (per cent)

Period	Revenue Deficit	Net Capital Expenditure	Net Loans and Advances
1985-2004	59.77	24.28	15.96
VIII Plan (1992-1997)	46.26	28.25	25.49
IX Plan (1997-2002)	63.26	19.53	17.20
2002-03	81.56	20.32	-1.87
2003-04	124.77	22.79	-47.56
Average Annual Rate of Change			
1985-2004	7.23	-4.25	

4.9 Revenue deficit continued to be the dominant component of fiscal deficit, accounting for nearly 60 *per cent* of it during 1985-2004. The proportion of revenue deficit in overall fiscal deficit increased from an average of 46.26 *per cent* during the VIII Plan (1992-1997) to 81.56 *per cent* in 2002-03. The ratio of revenue deficit - fiscal deficit had a positive shift rate of 7.23 *per cent* during 1985-2004. During 2003-04, revenue deficit exceeded the fiscal deficit for the first time by around 25 *per cent*. Net capital expenditure (capital expenditure- capital receipts) accounted for less than a quarter of fiscal deficit during 1985-2004. It also had a negative shift rate of 4.25 *per cent*. Fiscal deficit financed around 16 *per cent* of net loans and advances. In 2002-03 and 2003-04, recovery of loans and advances exceeded the issue of fresh loans and the surplus actually financed part of the fiscal deficit. Continuous use of borrowed funds for meeting current expenditure not only indicated erosion in assets back up, it made capital expenditure (inclusive of loans and advances) as variable of adjustment. Scarce borrowed resources could only be partly allocated for capital formation.

Primary Deficit

4.10 While fiscal deficit represents the need for additional resources in general, a part of such resources may be needed to finance interest payments. Interest payments represent the expenditure of past obligations and are independent of current allocative priorities. To look at the imbalances of the current nature, these payments may need to be separated and deducted from the total imbalances. Primary deficit, which represents the current imbalances net of interest payments, averaged Rs 17027 crore during 1985-2004, though it witnessed a decelerating trend. In 2003-04, there was a primary surplus as interest payments exceeded the fiscal deficit. In relation to GDP, primary deficit declined from an average of 1.77 *per cent* during the VIII Plan (1992-1997) to 0.41 *per cent* in 2002-03. It later turned positive in 2003-04. Trends in primary deficit and its parameters are indicated in table 4.4 below.

Table 4.4: Primary Deficit and its Parameters

(Rupees in crore)

Period	Revenue Deficit	Fiscal Deficit	Interest Payments	Primary Deficit	Primary Revenue Balances	As per cent of GDP	
						Primary Deficit	Primary Rev. Balances
1985-2004	42819	71644	54617	17027	11798	1.40	0.97
VIII Plan (1992-1997)	28941	62565	44280	18285	15339	1.77	1.48
IX Plan (1997-2002)	75711	119675	91102	28573	15391	1.49	0.80
2002-03	109765	134588	124573	10015	14808	0.41	0.60
2003-04	100986	80937	128114	-47177	27128	-1.70	0.98
Average annual trend rate of growth (per cent)							
1985-2004	18.22	10.25	17.57		13.40	-12.40	-0.64
VIII Plan (1992-1997)	10.88	6.42	17.44		Average Annual Rate of Change		
IX Plan (1997-2002)	17.29	9.00	14.90				
2002-03	-0.49	-13.63	9.11				
2003-04	-8.00	-39.86	2.84				

4.11 Interest payments of the Union government exceeded the revenue deficit all these years indicating that current revenue receipts were inadequate to meet even the revenue expenditure net of the payments for the past obligations. However, the primary revenue balances which averaged 1.48 *per cent* of GDP during the VIII Plan (1992-1997) declined to 0.98 *per cent* of GDP in 2003-04. (Primary revenue balances had declined to 0.60 *per cent* of GDP in 2002-03). Relative to revenue receipts, primary revenue surplus declined from an average of 11.66 *per cent* during the VIII Plan (1992-1997) to eight *per cent* in 2003-04.

4.12 Improvement in primary deficit from an average of 1.77 *per cent* of GDP to (-) 1.7 *per cent* of GDP in 2003-04 clearly indicates that in 2003-04 non-debt receipts were adequate to meet the expenditure incurred in that year, including the capital expenditure and loans and advances net of interest payments. However, that was largely due to increase in recovery of loans and not because of any acceleration in revenue receipts. Recovery of loans or accrual of miscellaneous capital receipts indicate a decline in assets base of the government and at best could be viewed as a limited temporary option.